April 3, 2001

Amy G. Rabinowitz
Associate Counsel
Massachusetts Electric Company
25 Research Drive
Westborough, MA 01582

Re: MECo's Default Service Pricing

Dear Attorney Rabinowitz:

On March 7, 2001, the Department approved MECo's request to procure default service supplies for each of its customer classes in one-third segments, with terms of six, twelve, and eighteen months (i.e., one-third of its supply requirements would be procured through a six-month contract, one-third through a twelve-month contract, and one-third through a eighteen-month contract). MECo followed this course of action for the residential and commercial customer classes; however, for the industrial customer class, MECo elected to procure one-third of its supply requirements for this customer class under a six-month contract and two-thirds of its supply requirements through a twelve-month contract. On March 20, 2001 Massachusetts Electric Company and Nantucket Electric Company (jointly "MECo" or the "Company") submitted the results of its most recent solicitation for default service and its proposed default service prices resulting from that solicitation ("MECo Filing").

MECo's proposal contains two pricing options for its customers: (1) a variable pricing option in which the price changes monthly based on the monthly bids submitted by the default service supplier(s); and (2) a fixed pricing option in which the variable monthly prices are averaged and remain constant over either six or twelve months (id. at 1-2). With respect to the calculation of the fixed price option, MECo's filing contained two proposals: (1) a six-month weighted average fixed pricing option consistent with the Department's guidelines, and (2) a twelve-month weighted average fixed pricing option using monthly supply contract prices from May 2001 through April 2002.[(1)] MECo supports the use of option two (id. at 2). MECo states that, if the Department is reluctant to depart from its pricing guidelines for all customer classes, it should do so for the residential class at a minimum, arguing that these customers "have no functional market alternatives today" (id. at 3).

It is important to note that MECo's twelve-month proposal does not reduce the price for any customers, it suppresses the market price signal as it would otherwise be experienced by customers nearer to the time of usage; and it does so by simply shifting the time-period over which default service supply costs must be paid. Under MECo's twelve-month proposal, default service customers will pay below-market prices (as determined by the Company's solicitation) during the initial six-month period. However, customers will pay above-market prices over the later six month period. There would be no savings to customers individually or in the aggregate; but seasonality in market price signals would be disguised.

In determining whether to accept the Company's proposal, the Department must consider the statutory requirement of requiring electric companies to charge electric default service customers at prices equal to procurement cost. The Act required that default service be procured through a competitive solicitation. We view the intent here as requiring default service be provided at market rates. While the monthly pricing option most effectively accomplishes this goal, our default service pricing guidelines also include a fixed six-month pricing option, consistent with the requirement of the Act.[(2)]

In Default Service Pricing and Procurement, D.T.E. 99-60-B (2000), the Department noted that as the period for which power is procured gets longer, greater uncertainty is introduced into the procurement process, which likely will result in a greater deviation (whether upward or downward will depend on the then prevailing market) between default service prices and actual monthly market prices. This deviation may result in default services prices that are not sufficiently indicative of market prices, which could hinder the development of a robust retail market. While the Company's six-month pricing proposal is consistent with our default service pricing guidelines, the twelve-month pricing proposal raises the concern we raised in establishing our guidelines. Moreover, MECo's twelve-month proposal creates added uncertainty in that the Company has not procured default service supply for the final third of its load for the second six-month period.[(3)] In fact, the costs of this uncertainty would be borne by future default service customers in any reconciliation of these yet unknown default service supply costs. Therefore, the Company's twelve-month fixed-pricing proposal would not serve the Company's customer base nearly as well as better awareness of the Company's budget billing plan, and expansion of that plan for certain customer classes.

In DTE 99-60-B, the Department recognized that all customers may avail themselves of a budget billing plan, whereby the customer's electric usage is projected for a period, equal monthly charges are calculated and billed for that period, and charges are reconciled with actual usage in the final billing for the period. 220 C.M.R. § 25.01(2). The availability of this important budget billing option,[(4)] coupled with the Company's commitment to effectively promote budget billing as a real and viable option, accomplishes effects that are substantially similar to the twelve-month pricing proposal offered by the Company and does not clash with the Act's requirement to price default service at market rates. In fact, budget billing goes beyond the Company's twelve-month average pricing proposal in that it not only averages prices, but also averages an individual customer's consumption pattern.

Maintaining the Department's six-month pricing option also sends the appropriate price signals to consumers about cost differences in various time periods. Preserving that signal is particularly important as we approach the summer peak period where generating capacity surplus margins are reduced. An appropriate price signal promotes efficient demand levels and further assures an adequate and reliable supply of electricity. Masking of seasonal price variability is an avoidance of reality that serves no one. Cf. Massachusetts Electric Company, D.T.E. 99-47, at 9, n.11 (2000). Preserving that signal (i.e., the variable cost of electricity from season to season) need not - - indeed does not - - conflict with a properly designed and marketed budget billing system. In fact, knowledge of price variability may help customers in their decision whether to use budget billing.

In DTE 99-60-B the Department established the six-month fixed price option as the customary default service pricing option for residential and small commercial and industrial customers. In order to smooth out price fluctuations, the Department will now direct the Company to expand its budget billing program option to include not only residential customers but also small commercial and industrial customers. In light of the expanded eligibility for the budget billing programs, the Department will require the Company to submit any changes necessary to terms and conditions to implement this policy. In addition, we direct the Company to modify its budget billing policies to use known or predicted price changes in estimating and reviewing a customer's average bill. Such changes must be submitted to the Department for review and approval in order for the modified budget billing to be available beginning with the May, 2001, billing cycle.

Sincerely,

James Connelly, Chairman

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

cc: Service List - D.T.E. 99-60

1. The calculation of the twelve-month average default service rates under the Company's proposal uses the actual monthly supply contract prices from May 2001 through October, 2001. For the last six months of this period (November 2001 through April 2002), the Company has contracted for only two-thirds of the default service supply (MECo Filing at 2). Therefore, there is uncertainty as to the cost of one third of the Company's default service load for the last six months.

2. As we stated in D.T.E. 99-60-B, we believe the Legislature intended to extend customers an option of price stability for "at least" six months. D.T.E. 99-60-B at

6-7, n.8. Therefore, the Department has the flexibility to extend the six-month pricing option should we deem it appropriate.

3. Compounding this concern is the added uncertainty regarding future installed capacity ("ICAP") costs. <u>See</u> <u>Central Maine Power Company v. Federal Energy Regulatory Commission</u>, No. 01-1376 and <u>Bangor Hydro-Electric Company, et al v. Federal Energy Regulatory Commission</u>, No. 01-1377 (1st Cir. Mar. 30, 2001) (Order granting stay of Federal Energy Regulatory Commission allowed ICAP deficiency charge).

4. Information available to the Department indicates that only a small percentage of the Company's residential customers (approximately two percent) use budget billing.